CalPERS

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AGENDA ITEM 3a

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

I. SUBJECT: State Legislative Proposal: Combine Benefit Levels in the 1959 Survivor Program for Public Agencies

II. PROGRAM: Legislation

III. RECOMMENDATION: Staff recommends that the Board **sponsor** legislation to combine levels 1, 2, and 3 of the 1959 Survivor Program for Public Agencies into a new pool paying current level 3 survivor benefit and suspend the $2 monthly employee premium.

IV. ANALYSIS:

Summary

This proposal is the same as Assembly Bill 1821 (Ma) that CalPERS sponsored last year which was vetoed by the Governor. It would combine the three closed levels (1st, 2nd, and 3rd) of the 1959 Survivor Benefit Program into a single public agency pool paying the current level 3 survivor benefit and suspend the $2.00 per month employee premium if the Board determines that the combined pool is running a surplus in excess of 200 percent of the total liabilities of the pool.

Background

The 1959 Survivor Benefit Program (Program) was created to provide a continuing pre-retirement monthly death benefit for CalPERS members not covered by Social Security, such as firefighters and police officers, and who elect to enroll in the Program and pay the monthly premium of $2 per month. The employer pays any additional costs necessary beyond the $2 per employee if the assets of the Program are unable to pay its liabilities.

The Program provides a monthly allowance to eligible survivors of members who were covered by this benefit program and died before retirement. Eligible survivors include a spouse or legally registered domestic partner to whom the member was married or registered for at least one year prior to death, or the occurrence of the injury or onset of illness resulting in the member's death. A surviving spouse is entitled to the 1959 Survivor Benefit as long as they care for an eligible child, or are at least age 62. A child who has never been married or stepchild (if the child was living with member in a parent-child relationship) who has never married is eligible for benefits while under age 22. A child who has never been married, who is incapacitated because of a disability that began before attaining age 22 may be entitled to the benefit until married or the disability ends. A parent who is at least age 62 may be eligible to receive the benefit if there were no surviving spouse/domestic partner or eligible children and if the parent was dependent on the member for at least half of their support at the time of the member's death.

The Public Agency Pool consists of five benefit levels and covers approximately 160,000 active members and 2030 existing or deferred benefit recipients. The Program only pays a COLA for the Indexed Level. All other benefit levels remain constant. Instead, new benefit levels are created, and old benefit levels are closed. The 1st and 2nd benefit levels have just over 12,000 participants and have been closed since 1994, while the 3rd benefit level has over 44,000 participants and has been closed since 2001.

	1st Level	2nd Level	3rd Level
Contracting Agencies	43	42	317
Active members	8,363	4,392	44,572
Deferred (Eligible, but not yet Receiving)	41	27	204
Receiving Benefits	83	62	456

Designed as a comparable benefit to Social Security, it is only payable if a member dies before retirement and is survived by one or more qualifying survivors. The amount paid depends on the number of qualified survivors.

Benefit Levels	One Survivor	Two Survivors	Three Survivors
1st Level (GC §21571)	$ 180	$ 360	$ 430
2nd Level (GC §21572)	225	450	538
3rd Level (GC §21573)	350	700	840
4th Level	950	1,900	2,280
Indexed	609	1,219	1,828

Discussion

Decreased Premium Risk

Combining the 1st, 2nd, and 3rd level pools and paying the 3rd level benefit will not only allow 1st and 2nd level contracting agencies to provide a modest benefit increase to their employees, it will also cut the premium risk in the year 2020 for current 3rd level employers by almost half. The 1st and 2nd level pools currently have large surpluses. If the risk pools for all three benefit levels were combined, the surpluses would reduce the current 3rd level pool's risk profile by adding more in additional funding than they add in additional liabilities. This allows CalPERS to eliminate the required member premiums for an extended period of time and reduces the probability of future premiums for the Program.

No COLA for Survivors

The Program was designed as a replacement benefit for members who are not eligible for Social Security. However, unlike Social Security, there is no mechanism allowing eligible survivors to receive a cost-of-living allowance (COLA). The 1st and 2nd level pools are no longer open to new members because the benefit they provide is insufficient for its original purpose. New benefit pools were created in order to provide a more realistic replacement benefit for eligible survivors. Merging the pools and paying the 3rd level survivor benefit would provide a needed COLA increase to participants in the 1st and 2nd level pools.

Legal Limits

The law does not allow these surplus funds to be used for anything other than paying benefits for participants in the Program. Thus, when significant surpluses accumulate over time, there becomes an opportunity cost to these funds. These costs include unnecessary exposure to capital market conditions and illiquidity. Illiquidity costs arise because the surplus can only be used to pay benefits and consequently they cannot be put to better use elsewhere. Allowing the surplus funds to be used to extend the life of the combined pool avoids such opportunity costs.

Value

The Program delivers a much-needed benefit to eligible survivors of contracting agency members that are not covered by Social Security. As indicated by the current surplus, it is able to do this at very little cost to employers and members. In 2009, the legislature agreed to make the state's 5th level benefit permanent for state and school employees by eliminating the sunset provision, a proposal sponsored by the Department of Personnel Administration and signed into law by the Governor. This clearly indicates the value of the Program as well as the need for higher benefit levels to offset inflation.

In addition, the 3rd level 1959 survivor is modest when compared to the Social Security benefit. The following matrix shows the typical Social Security benefit paid based on varying salary levels. These amounts are for calendar year 2010 and will include an annual cost of living adjustment.

Salary	Single Survivor Benefit	Two Survivor Benefit	Three Survivor Benefit
$25,000	$730	$1,460	$1,464
$50,000	1,130	2,260	2,770
Maximum Benefit*	1,590	3,180	3,710

*Maximum benefit payable regardless of salary level

Proposed Changes

This proposal would make the following changes in existing law:

- Merge level 1 and 2 members and assets into the level 3 pool, paying all members the level 3 survivor benefit of $350 per month for a single survivor and up to $840 per month for three or more survivors.
- Suspend the $2 monthly employee premium if the Board determines that the combined pool is running a surplus in excess of 200 percent of the total liabilities of the pool.
- Take effect July 1, 2012.

Legislative History

2010 AB 1821 (Ma)— Combines the three closed levels (1st, 2nd and 3rd) of the 1959 Survivor Benefit Program into a single contracting agency pool paying the current level 3 survivor benefit and suspends the $2.00 per month employee premium as long as the pool has at least double the required reserves. Vetoed. *CalPERS Position: Sponsor*

2009 Chapter 188 (SB 519, Ashburn)—Eliminated the sunset date for the 5th level 1959 Survivor Benefit for state and school members. This made the 5th level benefit permanent. *CalPERS Position: Support*

2003 Chapter 519 (AB 1584, Committee on PER&SS)—Provided that the assets and liabilities of all contracting agency employers participating in the 1st and 2nd level 1959 Survivor Benefit Program would be pooled into a single account paying a fifth level benefit. *CalPERS Position: Sponsor*

1999 Chapter 55 (SB 400, Ortiz)—Established that all survivors of state and school members were eligible for the 5th level 1959 Survivor Benefit. This eligibility was scheduled to remain in effect until January 1, 2010, unless extended by legislation. *CalPERS position: Support*

Chapter 801 (AB 99, Cedillo)—Created a new Indexed level 1959 Survivor Benefit for any survivor of a deceased local member whose employer elects to participate or who first contracted with CalPERS on or after January 1, 2000. *CalPERS position: Sponsor*

1993 Chapter 1160 (SB 887, Hughes)—Created a new 4th level 1959 Survivor Benefit for any survivor of a deceased local member whose employer elects to participate or who first contracted with CalPERS on or after January 1, 1994. *CalPERS position: Sponsor*

V. STRATEGIC PLAN

This legislative proposal is consistent with the following CalPERS Strategic Plan goals:

- Provide sustainable pension benefit products and services responsive to and valued by members, employers, and stakeholders
- Administer pension benefit services in a consumer-oriented and cost-effective manner.

VI. FISCAL IMPACT

Program Cost

The 6/30/2009 actuarial valuation shows the 1st and 2nd levels having large surpluses. Notwithstanding the recent market downturn, these pools are projected to experience continued surpluses as shown below.

Projected Assets and Liabilities as of June 30, 2010 using 13.3% return

Pool	Market Assets	Liability	Surplus	Funded Ratio
Level 1	$26,742,792	$ 2,300,072	$24,442,720	1163%
Level 2	$ 6,913,290	$ 2,020,389	$ 4,892,900	342%
Level 3	$70,817,772	$25,022,687	$45,795,085	283%

Combining the three pools and paying the higher level 3 benefits will increase the funded ratio for the combined pool to 305 percent due to the excess surpluses contained in the level 1 and level 2 pools. The Program will have no costs until this excess funding has been spent down. The amount of time necessary for this to occur will vary depending on the long-term rate of return received on investments, as well as demographic experience and future mortality rates. The most volatile of these potential factors is investment returns. If CalPERS were to achieve its expected long-term rate of 7.75 percent the Program would remain funded by excess revenues indefinitely. The addition of a 200 percent threshold for reinstating employee contributions substantially decreases the chance that employer premiums would be required at a future date.

Administrative Cost

The administrative costs associated with merging the benefit pools are minor and absorbable. In the long run, administrative cost will go down as a result of having one pool to administer rather than three pools.

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